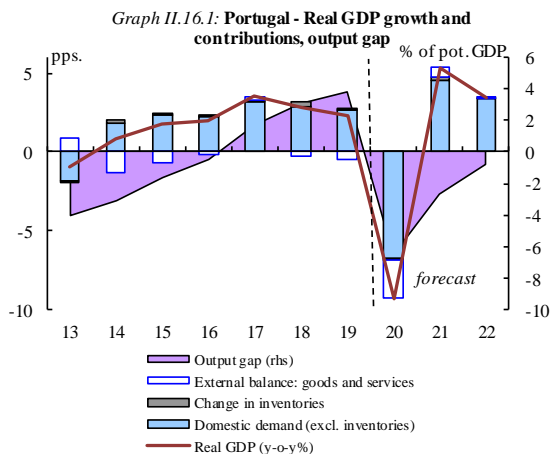


16. PORTUGAL

After a steep fall in GDP in the second quarter of 2020, Portugal's economy started to recover in the summer months. Activity in the hospitality sector, however, remained well below its pre-pandemic level and is set to recover only gradually. The labour market appeared more resilient but is still absorbing a large drop in hours worked and participation rates. Fiscal policy is being called to sustain the economy in 2020 and 2021, which puts a strain on public finances.

Economy gears up to a gradual recovery

Economic output in Portugal fell by 3.9% and 13.9% (q-o-q), respectively, in the first two quarters of 2020 as a result of the COVID-19 crisis. Tourism was the hardest hit sector. With the gradual relaxation of social distancing measures over the summer, the economy started to recover, and many sectors, particularly manufacturing, largely returned to their pre-pandemic levels. However, activity in the country's large hospitality sector remained well below capacity and is not expected to fully recover over the forecast period. The outlook for the sector has been further darkened by a rise of infections this autumn. Overall, GDP is projected to decline by 9¼% in 2020 and to grow by 5½% in 2021 and 3½% in 2022. Risks are still tilted to the downside due to Portugal's high reliance on foreign tourism where uncertainty remains significant.



Across domestic demand components, private consumption dropped by 13.3% (q-o-q) in the second quarter as 'forced' and precautionary household savings surged. Investment contracted by 9.8% overall amid a sharp decline in equipment investment but investment in construction maintained positive growth. Benefitting from the government's policy response to the crisis and the EU funding cycle, domestic demand is projected to return to pre-pandemic levels by the end of 2022.

In the external sector, exports fell more than imports. However, performance differed greatly across goods and services. While the balance of goods improved and trade volumes rebounded at a solid pace, the service balance suffered a large deterioration and has much worse recovery prospects. Foreign tourism, which accounted for 52% of Portugal's exports of services in 2019, plunged by more than 90% in the second quarter of the year and remained substantially below its pre-pandemic level over the summer. As a large part of the sector depends on air transport, Portugal is also facing increased competition from destinations more often reached by road.

Social measures cushion labour shocks

About 750,000 employees or nearly 15% of the labour force benefited from various temporary forms of state support at the height of the crisis. Consequently, the unemployment rate increased only moderately from 6.5% in 2019 to around 8% in August 2020. Employment had decreased by around 3% y-o-y as of August but part of its negative impact on unemployment was offset by a rise in inactivity. This also resulted in a substantial drop in labour utilisation, including forced paid and unpaid leave and a massive fall in hours worked (23.6% y-o-y in the second quarter). Benefitting from the expected economic recovery and further support measures, the unemployment rate is projected to gradually move close to its pre-pandemic level, from around 8.0% in 2020 to 6.6% in 2022.

Inflation set to pick up from a low level

The pandemic created a combination of supply and demand shocks, with opposite effects on prices. However, downward pressures due to low crude oil prices and weak consumer confidence are expected to prevail in the near term and headline inflation is forecast to remain subdued in 2020. Inflation is projected to gradually pick up in 2021, in line with the expected economic recovery and the projected increase in energy prices.

Public finances called to sustain the economy

The COVID-19 pandemic is projected to cause a worsening of the general government balance to a deficit of 7¼% of GDP in 2020, reversing last year's surplus. The operation of automatic stabilisers and fiscal policy support are expected to be the main drivers of this deterioration. In response to the COVID-19 crisis, policy measures were taken to reinforce the resilience of the health system, preserve jobs, provide adequate social support, safeguard business continuity, and support the resumption of activity, with an estimated overall direct budgetary cost of close to 3% of GDP. Portugal's multipronged package of policy measures is expected to lead to an increase in current expenditure, notably in subsidies and social transfers, as well as in capital expenditure linked to rescue aid to airlines. Excluding the impact of the third activation of Novo Banco's contingent capital mechanism (0.5% of GDP) and other one-off measures, the general government balance should reach a smaller deficit of 6¾% of GDP in 2020.

The deficit is projected to decrease to 4½% of GDP in 2021, on the back of the expected economic recovery and the lower fiscal burden of crisis mitigation measures. One-off revenue related to the reimbursement of the pre-paid margin that

was deducted from the financial assistance loan granted by the European Financial Stability Facility (0.5% of GDP) should contribute to a swifter reduction of the deficit. In line with the Draft Budgetary Plan for 2021, the forecast factors in additional public investment under the Recovery and Resilience Facility (¼ % of GDP). Risks to the budgetary forecast are tilted to the downside, linked to the piling up of public contingent liabilities stemming from some public corporations and the crisis mitigation measures targeting the private sector, which come on top of non-negligible pre-pandemic levels. Under a no-policy-change assumption, the improvement in public finances is projected to gain speed in 2022, amid a gradual phasing-out of fiscal policy support and further improving economic conditions.

The general government debt-to-GDP ratio is projected to spike at 135% in 2020, reflecting the sudden primary deficit and the unfavourable denominator effect arising from the expected contraction of nominal GDP. It is forecast to resume its decreasing path in 2021, when it is set to drop to 130¼%, helped by the expected rebound in GDP growth and the pre-financing of grants under the Recovery and Resilience Facility.

Table II.16.1:

Main features of country forecast - PORTUGAL

	2019			Annual percentage change						
	bn EUR	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP	213.3		100.0	0.3	3.5	2.8	2.2	-9.3	5.4	3.5
Private Consumption	136.3		63.9	0.5	2.1	2.6	2.4	-7.9	4.9	3.5
Public Consumption	36.0		16.9	0.4	0.2	0.6	0.7	1.0	1.6	0.8
Gross fixed capital formation	38.8		18.2	-2.6	11.5	6.2	5.4	-10.2	6.3	5.2
of which: equipment	12.2		5.7	-0.6	12.4	8.9	2.7	-30.7	15.2	9.9
Exports (goods and services)	92.8		43.5	3.9	8.4	4.1	3.5	-21.0	9.7	5.4
Imports (goods and services)	92.3		43.3	2.2	8.1	5.0	4.7	-15.6	7.5	5.0
GNI (GDP deflator)	208.4		97.7	0.3	3.6	2.7	2.4	-8.9	5.2	3.5
Contribution to GDP growth:										
Domestic demand				-0.1	3.2	2.8	2.6	-6.7	4.6	3.3
Inventories				0.0	0.1	0.3	0.1	-0.2	0.1	0.0
Net exports				0.4	0.2	-0.3	-0.5	-2.4	0.7	0.1
Employment				-0.5	3.3	2.3	0.8	-3.8	2.1	1.7
Unemployment rate (a)				9.8	9.0	7.1	6.5	8.0	7.7	6.6
Compensation of employees / head				1.8	2.3	3.9	3.5	0.6	2.3	1.8
Unit labour costs whole economy				1.0	2.1	3.4	2.0	6.7	-0.9	0.0
Real unit labour cost				-1.0	0.6	1.5	0.3	4.4	-2.2	-1.3
Saving rate of households (b)				9.5	6.6	6.8	7.0	12.2	9.8	7.5
GDP deflator				2.0	1.5	1.8	1.7	2.2	1.3	1.4
Harmonised index of consumer prices				2.0	1.6	1.2	0.3	-0.1	0.9	1.2
Terms of trade goods				0.4	-1.1	-0.8	0.5	2.1	0.0	0.0
Trade balance (goods) (c)				-9.3	-7.0	-7.8	-7.9	-6.3	-6.1	-6.2
Current-account balance (c)				-6.3	1.0	0.3	0.2	-0.9	-0.5	-0.5
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-4.8	1.8	1.2	1.0	0.2	0.6	0.5
General government balance (c)				-5.7	-3.0	-0.3	0.1	-7.3	-4.5	-3.0
Cyclically-adjusted budget balance (d)				-5.2	-3.9	-2.0	-2.0	-3.8	-3.0	-2.6
Structural budget balance (d)				-	-1.8	-1.3	-1.4	-3.3	-3.3	-2.6
General government gross debt (c)				93.8	126.1	121.5	117.2	135.1	130.3	127.2

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.